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In the Supreme Court
OF THE
United States

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CHARLES

OCTOBER TERM, 1935

No. 346

MATSON NAVIGATION COMPANY (a corporation), THE OCEANIC STEAMSHIP COMPANY (a corporation), and MATSON TERMINALS, INC. (a corporation),

Appellants,

vs.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA, JOHN C. CORBETT, FRED E. STEWART, R. E. COLLINS, H. G. CATTELL and RAY L. RILEY, the Members of Said State Board of Equalization, and CHARLES J. MCCOLGAN, Franchise Tax Commissioner of the State of California,

Appellees.

BRIEF FOR APPELLANTS.

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STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA, JOHN C. CORBETT, FRED E. STEWART, R. E. COLLINS, H. G. CATTELL and RAY L. RILEY, the Members of Said State Board of Equalization, and CHARLES J. McCOLGAN, Franchise Tax Commissioner of the State of California,

Appellees.

BRIEF FOR APPELLANTS.

This is an appeal from the judgment of the Supreme Court of the State of California affirming an order of

the appellee State Board of Equalization, approving an assessment levied against the appellants by the Franchise Tax Commissioner of the State of California. Appellants have heretofore filed the Statement as to jurisdiction on appeal required by Rule 12.

OPINION OF THE COURT BELOW.

The opinion of the court below is reported, *Matson Navigation Company, et al. v. State Board of Equalization, et al.*, 43 Pac. (2d) 805, 89 Cal. Dec. 434, 3 Cal. (2d) 1*, and is included in the record herein at pages 62 to 70.

The opinion of the State Board of Equalization is reported in Corporation Tax Service for California, published by the Corporation Trust Company, page 252, paragraph 1517, and is included in the record herein at pages 46 to 59.

STATEMENT OF THE CASE.

This appeal involves the validity of an assessment levied against appellants by the Franchise Tax Commissioner, and thereafter successively affirmed by the State Board of Equalization and the Supreme Court of California, under the California Bank and Corporation Franchise Tax Act (Statutes of California, 1929, page 19).

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*The official report, 3 Cal. (2d) had not yet been published when this brief was written, but we are informed by the official reporter that the page number stated above is correct.

Provisions of Constitution of California.

This act was adopted pursuant to the provisions of Article XIII, Section 16 of the Constitution of California, adopted November 6, 1928, and providing in part as follows:

> "Notwithstanding any other provision of this Constitution: * * *
>
> "2. (*a*) All financial, mercantile, manufacturing and business corporations doing business within the limits of this state, subject to be taxed pursuant to subdivision (*d*) of section 14 of this article, in lieu of the tax thereby provided for, shall annually pay to the state for the privilege of exercising their corporate franchises within this state a tax according to or measured by their net income. The amount of such state tax shall be equivalent to four per cent of their net income. Such tax shall be subject to offset, in a manner to be prescribed by law, in the amount of personal property taxes paid by such corporations to the state or political subdivisions thereof, but the offset shall not exceed ninety per cent of such state tax. In any event, each such corporation shall pay an annual minimum tax to the state, not subject to offset, of twenty-five dollars.
>
> "(*b*) The legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may provide by law for the taxation by any other method authorized in this Constitution of the corporations, or the franchises, subject to be taxed pursuant to subdivision (*a*) of paragraph 2 of this section or subdivision (*d*) of section 14 of this article."

The full text of this section is set forth as an appendix to this brief.

Article XIII, Section 14, subdivision (d) of the Constitution of California, referred to in the foregoing section, reads as follows:

> "All franchises, other than those expressly provided for in this section, shall be assessed at their actual cash value, in the manner to be provided by law, and shall be taxed at the rate of one per centum each year, and the taxes collected thereon shall be exclusively for the benefit of the state."

The Bank and Corporation Franchise Tax Act.

The California Bank and Corporation Franchise Tax Act, as it existed at the time of the imposition of the tax in dispute, contained the following provisions:

Sections 1, 2 and 3 imposed upon banks and national banking associations an annual tax according to or measured by their net income, to be computed at the rate of four per centum upon their net income for the next preceding year; and provided that in the case of such banks and banking associations, the tax should be in lieu of all other taxes and licenses except taxes on their real property and should be subject to offsets of ten per cent of their real property taxes. These sections have no application to appellants.

Section 4 provides as follows:

> "Every financial, mercantile, manufacturing and business corporation doing business within the limits of this state, of the classes referred to in subdivision 2(*a*) of Section 16 of article thirteen of the constitution of this state, shall annually pay to the state, for the privilege of exercising its corporate franchises within this state,

a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of four per centum upon the basis of its net income for the next preceding fiscal or calendar year.

"Each such corporation shall be entitled to an offset against said franchise tax, in the manner hereinafter provided, in the amount of taxes paid upon its real and personal property to any county, city and county, city, town, or other political subdivision of the state, but the total offset shall not exceed seventy-five per centum of the said franchise tax, and in no case shall the taxpayer be entitled to offset more than ten per centum of its said real property taxes.

"In any event, each such corporation shall pay annually to the state, for the said privilege, a minimum tax of twenty-five dollars.

"Taxes under this section and under sections 1 and 2 of this act shall accrue on the first day after the close of the 'taxable year,' as defined in section 11 hereof."

Section 5 contains the following definitions:

"The term 'corporation,' as herein used, shall include every financial corporation, other than a bank or banking association, and every mercantile, manufacturing and business corporation of the classes referred to in subdivision one (*c*) of section 5219 of the Revised Statutes of the United States.

"The term 'bank,' as hereinafter used, shall include national banking associations.

"The term 'doing business,' as herein used, means any transaction or transactions in the

course of its business by a corporation created under the laws of this state, or by a foreign corporation qualified to do or doing intrastate business in this state."

Section 6 defines "gross income" as follows:

"The term 'gross income,' as herein used, includes gains, profits and income derived from the business, of whatever kind and in whatever form paid; gains, profits or income from dealings in real or personal property; gains, profits or income received as compensation for services, as interest, rents, commissions, brokerage or other fees, or otherwise received in carrying on such business; all interest received from federal, state, municipal or other bonds, and, except as hereinafter otherwise provided, all dividends received on stocks."

Section 7 provides that "net income", as used in the act, means the gross income less the deductions allowed.

Section 8 defines the allowable deductions as including expenses, interest, taxes, losses and certain other items.

Section 9 denies the right to deduct for improvements or betterments and certain other outlays.

Section 10 of the act reads as follows:

"If the entire business of the bank or corporation is done within this state, the tax shall be according to or measured by its entire net income; and if the entire business of such bank or corporation is not done within this state, the tax shall be according to or measured by that portion thereof which is derived from business

done within this state. The portion of net income derived from business done within this state shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, payroll, value and situs of tangible property, or by reference to these or other factors, or by such other method of allocation as is fairly calculated to assign to the state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation.

"If the commissioner reallocates net income upon his examination of any return, he shall, upon the written request of the taxpayer, disclose to him the basis upon which his reallocation has been made."

Section 11 defines the terms "taxable year" and "fiscal year", and Section 12 provides for the adoption of the taxpayer's annual accounting period.

Section 13 provides for an annual corporate return and Section 14 for a consolidated return by affiliated corporations.

Sections 15 to 24, inclusive, contain various provisions with respect to the returns, the ascertainment of profits or losses in specific cases and the payment of the tax.

Section 25 provides that the Franchise Tax Commissioner may determine the amount of any proposed additional tax and notify the taxpayer, who may thereupon file a written protest. In the event the protest is denied by the Commissioner, an appeal may be taken to the State Board of Equalization.

Section 26, dealing with offsets, Section 27, with refunds, and Section 28 with fraud and evasion, are not here involved.

Section 29 declares that the taxes levied under the act shall be a lien on all property of the taxpayer.

Section 30 allows recovery by the taxpayer of taxes paid under protest, and Section 31 provides for a civil action by the state to collect the tax from the general corporate assets.

Section 32 provides that if the tax is not paid within twelve months after delinquency, "the corporate powers, rights and privileges of a delinquent taxpayer, if it be a domestic corporation, shall be suspended, and if the delinquent taxpayer be a foreign corporation, it shall thereupon forfeit its right to do intrastate business in this state". This section further provides:

> "Any person who attempts or purports to exercise any of the rights, privileges or powers of any such domestic corporation, or who transacts or attempts to transact any intrastate business in this state in behalf of any such foreign corporation shall be guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not less than two hundred fifty dollars and not exceeding one thousand dollars, or by imprisonment in the county jail not less than fifty days or more than five hundred days, or by both such fine and imprisonment. * * * Every contract made in violation of this section is hereby declared to be voidable."

The remaining provisions of the act are not material to the questions here involved. A copy of the complete text of the act is set forth in the appendix to this brief.

By amendment to the statute in 1933, it was provided that the decision of the State Board of Equalization might be reviewed by the Supreme Court of California on writ of certiorari. The provisions with respect to the appeal to the State Board of Equalization from the Franchise Tax Commissioner, which were contained in Section 25 of the act, were amended to read as follows:

> "The appeal must be addressed and mailed to the State Board of Equalization at Sacramento, and a copy of the appeal addressed and mailed at the same time to the commissioner at Sacramento. Said board shall hear and determine the same and thereafter shall forthwith notify the taxpayer and the commissioner of its determination, and the reasons therefor, which shall be final upon the expiration of sixty days from the time of such determination, unless within such sixty-day period the commissioner shall apply to the Supreme Court of the State for a writ of certiorari or review for the purpose of having the lawfulness of the decision of the State Board of Equalization inquired into and determined." (Statutes of California, 1933, page 699.)

The review of the ruling of the State Board of Equalization by the Supreme Court was provided for by amendment to Section 30, reading as follows:

> "Within sixty days after the determination of the State Board of Equalization of any appeal

from the action of the commissioner either the commissioner or the appellant may apply to the Supreme Court of the State for a writ of certiorari or review for the purpose of having the lawfulness of the decision or order of the board inquired into and determined. Such writ shall be made returnable not later than thirty days after the date of the issuance thereof, and shall direct the board to certify its record in the case to the court. On the return day, the cause shall be heard by the Supreme Court, unless for a good reason the same be continued. No new or additional evidence may be introduced in the Supreme Court, but the cause shall be heard on the record of the board as certified to by it. The review shall not be extended further than to determine whether the board has regularly pursued its authority, including a determination of whether the decision or order under review violates any provision of the Constitution of the United States, or of the State of California. The findings and conclusions of the board on questions of fact shall be final and shall not be subject to review. The board and each party to the proceeding before the board shall have the right to appear in the review proceeding. Upon the hearing, the Supreme Court shall enter judgment either affirming or setting aside the order or decision of the board. The provisions of the Code of Civil Procedure of this State relating to the writs of review shall, so far as applicable and not in conflict with the provisions of this act apply to proceedings instituted in the Supreme Court under the provisions of this section." (Statutes of California, 1933, page 703.)

The Appellants and Their Business.

The appellants, Matson Navigation Company and The Oceanic Steamship Company, are corporations organized under the laws of California.

Matson Navigation Company is, and was at all times involved herein, engaged in the transportation of goods and passengers between ports in the territory of Hawaii and ports on the Pacific Coast of the United States. All of its transportation business is, and was at all said times, interstate and foreign. All of the revenue of Matson Navigation Company involved in the dispute arose out of the transportation of passengers and merchandise in interstate and foreign commerce.

The Oceanic Steamship Company is, and was at all said times, engaged in the transportation of passengers and goods between ports in the South Sea Islands, Australia and New Zealand and ports in the territory of Hawaii and the Pacific Coast of the United States. As in the case of Matson Navigation Company, all of its transportation business is and was interstate and foreign. All of the revenue of The Oceanic Steamship Company involved in the dispute arose out of its transportation of passengers and merchandise in interstate and foreign commerce.

The foregoing facts were stipulated by the parties before the Supreme Court (R. 60). It was further stipulated that none of the transportation business of either of said companies is or was intrastate in its nature and that no goods, wares, merchandise or passengers are, or ever were, transported by either of said companies between points within the State

of California (R. 60). It was further stipulated that:

> "Although the transportation business of Matson Navigation Company and The Oceanic Steamship Company was conducted exclusively in interstate and foreign commerce, and although the additional assessment in controversy was computed based entirely upon a part of the revenue derived from such transportation in interstate and foreign commerce, nevertheless the petitioners (appellants) did engage, during the years 1930 and 1931, in other substantial activities of a purely intrastate character, the tax computed upon the revenue from such purely intrastate business having been already paid and not being involved in the present controversy" (R. 61).

Matson Terminals, Inc., is interested in this proceeding only in so far as it is a party to a consolidated return. No portion of the tax which is under attack in these proceedings is apportionable to this company. All of the transportation activities of the two other appellants are interstate or foreign.*

The Tax in Dispute.

The tax in dispute in this case is that imposed under the Bank and Corporation Franchise Tax Act for the year 1931, which, under the act, is measured by the net income of the companies for the preceding year. Matson Navigation Company and The Oceanic Steamship Company, in filing their 1931 return, omitted from the statement of their net income all portions thereof derived from interstate or foreign com-

*Unless otherwise noted, the word "appellants", when used herein, refers only to appellants Matson Navigation Company and The Oceanic Steamship Company, and not to Matson Terminals, Inc.

merce, and paid a tax of $12,845.30, which was computed by applying to the other net income, i. e., to the net income derived from their intrastate activities, the rate prescribed by statute. The Franchise Tax Commissioner, on March 5, 1932, gave notice of intention to impose an additional tax of $101,045.92 (R. 12-14), this amount including a levy of 4% of the total income from the interstate and foreign transportation business of the appellants. Appellants protested against this proposed assessment and thereafter, on November 23, 1932, the Franchise Tax Commissioner, after notice and hearing, imposed an additional tax of $19,637.71 (R. 14-15) (instead of the $101,045.92 originally proposed to be assessed). This is the tax which is in dispute in the present proceeding. The Commissioner arrived at this amount by allocating to California 22.2% of the total net income derived from the interstate and foreign transportation business of appellants, this percentage representing the proportion of the net income which had been derived from freight and passenger business originating in the State of California. As the Supreme Court states:

> "In arriving at this result, the commissioner allocated to income from business done in this state that portion of petitioners' income from its transportation business done within and without the state which the amount of business originating in this state bore to the total business done" (R. 63).

The transportation business referred to by the Supreme Court was entirely interstate and foreign.

Pursuant to the statutory procedure, appellants took an appeal from the ruling of the Franchise Tax Commissioner to the State Board of Equalization, asserting, among other things, that the tax thus imposed violated the provisions of the Constitution of the United States and constituted a tax and burden upon interstate and foreign commerce. The assessment of the Commissioner was, on February 15, 1934, affirmed by the State Board of Equalization (R. 59).

Thereupon the appellants, pursuant to the provisions of Section 30 of the Bank and Corporation Franchise Tax Act, as amended in 1933, filed a proceeding in certiorari in the Supreme Court of California to review the ruling of the State Board of Equalization. The hearing of the writ of certiorari was had upon the petition (R. 7-15), and a stipulation which set forth the nature of appellants' transportation business, the fact that it was entirely interstate and foreign and further declared that:

> "It is only this revenue from interstate and foreign transportation business of Matson Navigation Company and The Oceanic Steamship Company upon which the additional assessment, the validity of which was assailed before the Board of Equalization and is now involved in this proceeding, is based" (R. 60).

The stipulation set forth the contentions of the parties as follows:

> "It is the view of the Commissioner that, in computing the tax he did not levy a tax on income from interstate and foreign commerce as such, but included a portion, to wit, 22.2% of such income in petitioners' net income allocated to

> California. The petitioners contend that the Commissioner had no right to allocate to California any portion of such income. Respondents contend that, petitioners being domestic corporations, it was proper for the Commissioner to allocate to California a portion of the income from interstate and foreign commerce, based upon the percentage of such business originating in California" (R. 61).

In their argument before the Supreme Court, appellants made two major contentions: first, that the Bank and Corporation Franchise Tax Act, as it existed in 1931, should not be interpreted as permitting the measurement of the tax by any part of the net income from interstate or foreign commerce; and second, that if the act were interpreted so as to permit the measurement of the tax by the income from such interstate or foreign commerce, it would violate the provisions of the Federal Constitution (R. 64).

The Supreme Court of California, by its decision of March 27, 1935, overruled both contentions. It held that the tax was imposed upon corporations "for the privilege of exercising their corporate franchises within this state * * * whether engaged in interstate or foreign commerce or not, so long as such corporation is doing some intrastate business as well"; that the act imposes the franchise tax "for the privilege of engaging in intrastate commerce" and that where a corporation is engaged both in intrastate *and* interstate commerce, "income from interstate or foreign commerce shall be included in measuring the tax to the extent limited in the act"; and, finally, that

"there is nothing in the section (Sec. 10) which even by implication excludes from the measure of the tax imposed for the privilege of exercising the corporate franchise to do intrastate business, income from interstate or foreign commerce which is reasonably attributable to business done within this state" (R. 66, 67).

The second contention of appellants, with respect to the constitutionality of the act, was likewise overruled (R. 67-70). A petition for rehearing having been denied by the Supreme Court of California on April 25, 1935 (R. 78), the present appeal was taken.

SPECIFICATION OF THE ASSIGNED ERRORS INTENDED TO BE URGED.

The appellants have heretofore filed their statement of the points relied on, in conformity with Rule 13 (R. 79-81). Assignments of error were duly filed (R. 1-4). The following is a summary of the errors relied upon:

(1) The Supreme Court of California erred in holding that the State Bank and Corporation Franchise Tax Act does not violate Section 8 of Article I of the Constitution of the United States and in holding that it does not impose a tax on interstate and foreign commerce, although it held that said act imposed an excise tax on the doing of business and allowed the levy of a tax thereunder, not only on the local business of appellants, but also upon a part of their interstate and foreign business, to wit: that part of such

interstate and foreign business which originated in California (Assignments of Errors, Nos. 1, 2, 3, 4, 7, 10, 13, 14).

(2) The Supreme Court of California erred in holding that said act does not deny to appellants the equal protection of the laws, although it purports to tax the intrastate business of all corporations alike, but measures the tax, in the case of appellants, in part by their interstate and foreign business and, in the case of other corporations doing no interstate or foreign business, measures the tax by the intrastate business alone (Assignment of Errors, Nos. 5, 8, 11, 15).

(3) The Supreme Court of California erred in holding that the said act does not deprive appellants of their property without due process of law, although it imposes a tax arbitrarily and without reasonable foundation upon interstate and foreign commerce for the purpose of measuring a tax on the intrastate and local business of appellants (Assignments of Errors, Nos. 6, 8, 12).

SUMMARY OF ARGUMENT.

I. The tax is an excise tax upon the actual doing of business.

II. The tax in its actual operation is a burden on interstate and foreign commerce.

(a) The nature of the tax, and its effect upon interstate commerce, is determined by its actual operation and not by the name which

may be given it by the state legislature or the state courts.

(b) Transportation is commerce.

(c) It is immaterial that the taxpayer is engaged in intrastate as well as interstate commerce, if in fact interstate commerce is burdened.

(d) The objection that the state tax constitutes an actual burden upon interstate and foreign commerce loses none of its validity because of the fact that the particular taxpayer happens to be a domestic corporation.

III. The tax is not a mere incidental burden on interstate and foreign commerce.

(a) The present tax is not a property tax.

(b) Cases involving income taxes do not apply. Cases providing for the equitable apportionment of the value of a unitary business do not apply.

(c) Cases dealing with the taxation of the "right to be" of a corporation have no application.

IV. Even construed as the state says it should be, this tax is an occupation tax; and being increased because of interstate business done, is void.

V. The state statute, as interpreted, denies to appellants the equal protection of the laws.

VI. The state statute, as interpreted, deprives appellants of their property without due process of law.

ARGUMENT.

I. THE TAX IS AN EXCISE TAX UPON THE ACTUAL DOING OF BUSINESS.

The state act was passed pursuant to the provision of the state constitution that

> "all financial, mercantile, manufacturing and business corporations doing business within the limits of this state * * * shall annually pay to the state for the privilege of exercising their corporate franchises within this State a tax according to or measured by their net income. The amount of such state tax shall be equivalent to four per cent of their net income."
>
> *Constitution of California,* Article XIII, Sec. 16.

The tax is imposed only on such corporations as are "doing business within the limits of this state". The tax is defined as one "for the privilege of exercising their corporate franchises" within the state.

The same limitation and description of the tax is repeated in the statute itself. It provides (in Section 4) that "every financial, mercantile, manufacturing and business corporation doing business within the limits of this state * * * shall pay annually to the state, for the privilege of exercising its corporate franchises within this state, a tax according to or measured by its net income * * *". By the same section an offset is allowed "against said franchise tax" and a minimum tax is provided "for the said privilege".

Stat. Cal. 1929, p. 20.

In view of the statutory language alone, it is clear that the tax is an excise or privilege tax and is levied upon the doing of business within the state. The remedies for the collection of the tax are not confined to the ordinary proceedings to collect property taxes. Under Section 31, suit may be brought against the corporation and judgment obtained for the amount of the delinquent tax (*Stat. Cal. 1929,* p. 32). In addition, if the tax is not paid within twelve months after delinquency in the first installment, the corporate powers, rights and privileges are suspended, if the corporation be a domestic one, and the right to do intrastate business is forfeited, if it be foreign. Any attempt to exercise such rights after suspension or forfeiture is a crime (Sec. 32, *Stat. Cal. 1929,* p. 33). The tax, therefore, has all the essential elements of a license tax, with the usual penalty that business cannot be carried on if the tax is not paid.

The tax is levied on the doing of business and not upon the right "to be" a corporation, which is granted by the state of creation to its own domestic corporations. This is clear from the terms of the act, which restricts the levy to those corporations which are "doing business". It is also clear from the fact that the tax is levied alike on all corporations, including, without distinction, both domestic corporations deriving their "right to be" from the taxing state and also foreign corporations. This circumstance was held to be sufficient to show that a tax was not levied on the right of corporate existence in *Philadelphia and Southern Steamship Co. v. Pennsylvania,* 122 U. S. 326, 342. Referring to the earlier case of *State Tax*

on Railway Gross Receipts, 15 Wall. 284, the court said:

> "The second ground on which the decision referred to was based was, that the tax was upon the franchise of the corporation granted to it by the State. We do not think that this can be affirmed in the present case. It certainly could not have been intended as a tax on the corporate franchise, because, by the terms of the Act, it was laid equally on the corporations of other States doing business in Pennsylvania."

We are not, however, left to inference from the statutory language for the purpose of showing that the tax under discussion is not levied upon the right to exist, or upon the right to use the corporate form, granted by the state of incorporation. The question has been settled by decision of the Supreme Court of California. In *Union Oil Associates v. Johnson,* 2 Cal. (2nd) 727, a California corporation which merely held stock in another company and engaged in no other activity than the receipt and disbursements of dividends, was held not to be liable to taxation under the Bank and Corporation Franchise Tax Act, because it was not a "business" corporation and was not engaged in "doing business".

In this respect the case is identical with *Anglo-Chilean Nitrate Sales Corporation v. Alabama,* 288 U. S. 218, where this court held that the corporate franchise tax of Alabama "is laid, not upon the authorization, right or privilege to do business in Alabama, but upon the actual doing of business" for the reason that the State Supreme Court had held, in

State v. National Cash Credit Association, 224 Ala. 629, that a corporation which merely invested in and owned property in the state was not subject to the tax. *Union Oil Associates v. Johnson,* supra, determines with equal finality that the California tax now before the court is laid on the actual doing of business, and "not upon the authorization, right or privilege to do business".

Under the act, as thus interpreted, a corporation which derives its corporate existence from the state need not pay the tax unless it actually engages in "doing business" within the state. If it "does business" within the state, it must pay the tax on the same basis, whether it derives its corporate life from California or from some other jurisdiction. The excise, therefore, is upon the transaction of business by the corporation and not upon the right of corporate existence.

The nature of the tax is similarly described in the decision of the Supreme Court of California in the present case, where it is said:

> "the act was intended to and by its terms does impose on the corporations of the type mentioned, for the privilege of exercising their corporate franchises within this state the tax therein provided, whether such corporation is a foreign or domestic corporation, and whether engaged in interstate or foreign commerce or not, so long as such corporation is doing some intrastate business as well."
>
> *Matson Navigation Co. et al. v. State Board of Equalization, et al.,* 43 Pac. (2nd) 805. (R. 66.)

Aside from the language of the statute itself, it appears by decisions of the highest court of the state that:

(1) The tax is not an income tax.

The Pacific Co. Ltd. v. Johnson, 212 Cal. 148.

(2) The tax is not a tax on the "right to be" or corporate existence of domestic corporations, or upon the right to enjoy corporate facilities.

Union Oil Associates v. Johnson, 2 Cal. (2nd) 727.

Especially as the act itself levies the tax indifferently upon all corporations, whether domestic or foreign.

Philadelphia and Southern Steamship Co. v. Pennsylvania, 122 U. S. 326.

(3) The tax is an excise tax upon the actual doing of business, and not upon the mere authorization to do business.

Union Oil Associates v. Johnson, 2 Cal. (2nd) 727;

Anglo-Chilean Nitrate Sales Corporation v. Alabama, 288 U. S. 218;

Matson Navigation Co. v. State Board of Equalization, 43 Pac. (2nd) 805.

II. THE TAX IN ITS ACTUAL OPERATION IS A BURDEN ON INTERSTATE AND FOREIGN COMMERCE.

The tax against appellants being not an income tax, nor a tax upon the right to be a corporation, but being an excise tax on the doing of business, the question

remains whether in actual operation it is a tax upon interstate or foreign commerce.

This question is answered by considering what was done by the state officials under the law in the present case.

The appellants' business was not confined to interstate and foreign commerce. They also engaged in other activities "of a purely intrastate character" (R. 61). The tax of 4% computed upon the revenue from these purely intrastate activities, amounting to $12,845.30, was shown by appellants' return to be due and has been paid by them and is not involved in the present controversy (R. 61).

The Franchise Tax Commissioner, acting under section 25 of the statute, thereupon proposed to assess, and after overruling the protest of appellants, did assess, an additional tax of $19,637.71. The Commissioner reached this figure by taking the total net income received by appellants from their interstate and foreign transportation business, and by allocating to California 22% of this income, "that percentage correctly representing the proportion of the net income derived from business originating in this state" (R. 63). He thereupon assessed the four per cent tax against the 22% thus ascertained.

In other words, the Commissioner held

(1) that the tax with respect to the intrastate business of appellants had been fully paid,

(2) that there should be assigned or allocated to California, from the total net income of appellants derived from their interstate and foreign

transportation business, such proportion thereof as the interstate and foreign business of appellants originating in California bore to the total amount of their interstate and foreign transportation business,

(3) that the proportion aforesaid being 22.2%, an additional tax should be imposed upon appellants, equal to four per cent of 22.2% of the total net income of appellants from their interstate and foreign transportation business.

It is clear, therefore, that the additional tax was computed on a definite part of the income from an interstate and foreign transportation business. This basis of computation was approved by the State Board of Equalization (R. 57-59) and by the Supreme Court (R. 63, 64).

Appellants contended before the Supreme Court that income from interstate and foreign commerce was not income from business "done within the state" within the meaning of section 10 of the act. This contention was expressly overruled by the Supreme Court, which held that in cases where a corporation was engaged in both intrastate and interstate commerce, the act should be interpreted as providing "that income from interstate or foreign commerce shall be included in measuring the tax to the extent limited in the act" (R. 67).

The Supreme Court further held that the formula adopted by the Commissioner in the present case (i. e., the allocation to California of that proportion of the total net income from interstate and foreign business

which interstate and foreign business arising in California bore to the total amount of interstate and foreign business) "is well calculated to accomplish the purpose" provided in the clause of Section 10, which declares that any formula for apportioning business done within the State of California must be "fairly calculated to assign to the state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation" (R. 66).

The Supreme Court held, therefore, that the Commissioner acted in full compliance with the statute when he (1) included income from interstate and foreign commerce in measuring the tax, (2) assigned to California as "business done within the state" the portion of such income which resulted from interstate or foreign business originating in the state, and (3) computed the tax on this part of the income from interstate and foreign commerce.

It is submitted that the act, as thus interpreted and applied, necessarily and inevitably burdens and regulates the conduct of interstate and foreign commerce. The Supreme Court held that the act should be interpreted as justifying a process of assessment which involves these steps:

(a) An ascertainment of the net income from intrastate business and the assessment of a tax thereon at the statutory rate;

(b) The ascertainment of the total income from interstate and foreign business;

(c) The ascertainment of that proportion of (b) which the interstate and foreign business originating in California bears to the total interstate and foreign business; and

(d) An assessment at the statutory rate upon the result obtained by process (c), over and above the tax ascertained by process (a).

Both sides are agreed that process (a) is proper. Appellants contend that the process involved in steps (b) to (d) is directed solely at interstate and foreign commerce and necessarily constitutes a burden upon them.

The tax, by the very method of its ascertainment and imposition, as it was ascertained and imposed in the present case, burdens the transaction of interstate and foreign transportation. The act is interpreted to mean that after the ascertainment of profits from intrastate business and the imposition of a tax thereon, an additional tax must be imposed equivalent to a percentage of all profits derived from transportation which is purely interstate and foreign. The interstate and foreign business is declared by the State Supreme Court to be one of the objects towards which the tax is directed. It is the target towards which the arrow is aimed. For the court says in so many words that

"the act clearly, without ambiguity, imposes on foreign and domestic corporations * * * when they are engaged in both intrastate and interstate commerce, for the privilege of engaging in intrastate commerce, a franchise tax measured by or according to their net income, and that the act

provides in such cases that income from interstate or foreign commerce shall be included in measuring the tax to the extent limited in the act."

This language defines the scope of a tax on the actual doing of business. For failure to pay it the right to do business is forfeited. No corporation which does any intrastate business at all can engage in any interstate or foreign business at all without being subjected to this burden upon its interstate or foreign activities. The essence of the burden is not effectively disguised by the use of the glib phrase that the tax is one "for the privilege of engaging in intrastate commerce". The attempt to reach the avails of interstate and foreign commerce is none the less obvious and is indeed frankly avowed.

Nor can the incidence of the tax, as a discouragement to the transaction of interstate and foreign business, be disguised because it is measured by the profits therefrom, rather than by the instrumentalities used therein or the total receipts yielded thereby. Profit is the inducement for engaging in trade and commerce. If the state may say, with specific intent directed at such commerce, that all profits therefrom must pay their toll and that all right to do intrastate business will be forfeited for non-payment of the toll, such trade and commerce is burdened just as effectively as by direct prohibition. The statute, as interpreted by the state Supreme Court, comes within the condemnation of all state legislation which in its operation constitutes a burden on interstate and foreign commerce. It provides for the exaction of a tax on the actual carrying

on of interstate and foreign commerce and is therefore unconstitutional and void.

Leloup v. Port of Mobile, 127 U. S. 640;
Sprout v. South Bend, 277 U. S. 163;
New Jersey Bell Telephone Co. v. State Board of Taxes, 280 U. S. 338;
Cooney v. Mountain States Telephone and Telegraph Co., 294 U. S. 384;
Looney Co. v. Crane Company, 245 U. S. 178;
International Paper Co. v. Massachusetts, 246 U. S. 135;
Alpha Portland Cement Co. v. Massachusetts, 268 U. S. 203;
Cudahy Packing Co. v. Hinkle, 278 U. S. 460;
Air-Way Electric Appliance Corporation v. Day, 266 U. S. 71.

Not only is the tax bad because of its actual imposition of a burden on interstate commerce, but the logical effect of the state court's interpretation is to include interstate commerce in the statute's professed object, as well as in its measure. For the Supreme Court holds that when the act provides that the tax shall be measured by "the portion of net income reasonably attributable to business done within this state" (Sec. 10), it thereby defines the measure of the tax as including a part of the income from interstate and foreign commerce; and this necessarily on the theory that "business done within this state" includes some interstate and foreign business. But the identical phrase "within this state" is used in defining the subject and object of the tax in Section 4, which de-

clares that the tax is levied "for the privilege of exercising its corporate franchises within this state". If the phrase in Section 10 fixes a measure inclusive of some interstate and foreign commerce, it is evident that the object sought to be reached, as expressed in the same phraseology, must include the same interstate and foreign activities.

The State Supreme Court seems to assume that the burden on interstate and foreign commerce is permissible because the tax reaches, not all the avails of such commerce, but only so much thereof as arose from business originating in California. This, we submit, involves a misconception of the immunity of interstate commerce from state regulation. This immunity extends to traffic *from* California as well as traffic *into* California. The state may not forbid passengers and freight from leaving the state, any more than it can forbid their entrance. Not being able to forbid the departure, it cannot levy a burden thereon by taxation, as it purports to do by the present statute, as now interpreted.

Furthermore, the statute by its necessary operation regulates the manner of carrying on interstate commerce. If perchance 90% of the business of Matson Navigation Company between San Francisco and Honolulu should originate in San Francisco, the California tax would be correspondingly increased. If, on the contrary, 90% of the business should originate in Hawaii, the tax would be correspondingly lightened. Necessarily, therefore, the tax would tend to encourage transportation to California in interstate and

foreign commerce and discourage transportation therefrom.

This means of taxation, if allowed, would enable each state to compete with others by the imposition of competitive rates, so that the state which imposed the highest rate on the transportation of persons and freight from its borders could prevent the passage of persons and property to other jurisdictions. No plainer case of attempted control over interstate and foreign commerce could be imagined.

The Nature of the Tax, and its Effect Upon Interstate Commerce, is Determined by its Actual Operation and Not by the Name Which May be Given it by the State Legislature or the State Courts.

The statute here involved is in form and in substance a tax on the doing of business. As shown above, the Supreme Court so describes it and so enforces it. The tax is imposed only when business is done, and, in the absence of business done, does not apply.

In the present case it was held by the Supreme Court that it operates on business done purely in interstate and foreign commerce. This actual operation of the statute controls the present appeal. It is immaterial that the Supreme Court of the state refers to the tax, in its opinion, as one upon business done "in intrastate commerce".

The State Supreme Court's description of the tax arose in the following way. Appellants contended "that the Franchise Tax Act, properly construed, does not include in its tax base income derived

from interstate or foreign commerce" (R. 64), and, specifically, contended that the words "business done within this state", as used in Section 10 of the act, were restricted to intrastate business and did not include interstate or foreign commerce. This contention was overruled by the Supreme Court, which held that income from interstate or foreign commerce should be included in measuring the tax and that the statute, in referring to "business done within this state", included not only intrastate but interstate and foreign business as well. In this respect the Supreme Court said:

> "We think that by section 4 of the act as limited by sections 5 and 10, as above quoted, the act was intended to and by its terms does impose on the corporations of the type mentioned, for the privilege of exercising their corporate franchises within this state, the tax therein provided, whether such corporation is a foreign or domestic corporation, and whether engaged in interstate or foreign commerce or not, so long as such corporation is doing some intrastate business as well. We are likewise of the opinion that the act clearly, without ambiguity, imposes on foreign and domestic corporations of the classes mentioned, when they are engaged in both intrastate and interstate commerce, for the privilege of engaging in intrastate commerce, a franchise tax measured by or according to their net income, and that the act provides in such cases that income from interstate or foreign commerce shall be included in measuring the tax to the extent limited in the act.
>
> "Petitioners' contention that the words 'derived' from business done within this state' found in section 10, must be construed to mean business

> solely done in intrastate commerce, is untenable. When standing alone, such words may be capable of the interpretation contended for (*Pacific Express Co. v. Siebert,* 142 U. S. 339), but when read with the rest of section 10 and with sections 4 and 5, they cannot be so interpreted without doing violence to the language used and without imposing limitations not therein contained. Section 10, in the interests of avoiding double taxation, does limit section 4 to the extent of excluding from the measure of the tax income from business done entirely outside the state, but reasonably and properly construed, there is nothing in the section which even by implication excludes from the measure of the tax imposed for the privilege of exercising the corporate franchise to do intrastate business, income from interstate or foreign commerce which is reasonably attributable to business done within this state" (R. 66, 67).

The Supreme Court of the state, therefore, held that the measure of the tax included (a) income from intrastate business and also (b) income from interstate or foreign commerce "which is reasonably attributable to business done within this state".

Having so held, the gratuitous description of taxation as having been imposed "for the privilege of engaging in intrastate commerce" is meaningless and cannot change the real nature of the exaction.

> "A state may not burden interstate commerce or tax property beyond her borders under the guise of regulating or taxing intrastate business."
>
> *Alpha Portland Cement Co. v. Massachusetts,* 268 U. S. 203, 218;
>
> *Cudahy Packing Co. v. Hinkle,* 278 U. S. 460, 466.

The tax must be tested "by its substance—its essential and practical operation—rather than its form or local characterization".

International Paper Co. v. Massachusetts, 246 U. S. 135, 142;

Air-Way Electric Appliance Corporation v. Day, 266 U. S. 71, 82.

The test is whether "the facts do or do not demonstrate that the tax as, a practical matter, constitutes a burden upon interstate commerce".

Ozark Pipe Line Corp. v. Monier, 266 U. S. 555, 562.

"Neither the state courts nor the legislatures, by giving the tax a particular name or by the use of some form of words, can take away our duty to consider its nature and effect. If it bears upon commerce among the states so directly as to amount to a regulation in a relatively immediate way, it will not be saved by name or form."

Galveston, Harrisburg and San Antonio Ry. Co. v. Texas, 210 U S. 217, 227.

"But the disavowal by the State of any purpose to burden interstate commerce cannot conclude the question as to the fact of such a burden being imposed, or as to the unconstitutionality of the state as shown by its necessary operation upon interstate commerce."

Western Union Telegraph Co. v. Kansas, 216 U. S. 1, 27.

Although the subject purported to be taxed is within the power of the state, the measure of the tax will be

scrutinized to determine whether the exaction burdens interstate commerce.

Western Union Telegraph Co. v. Kansas, 216 U. S. 1;

Ludwig v. Western Union Telegraph Co., 216 U. S. 146;

Looney v. Crane Co., 245 U. S. 178.

Transportation is Commerce.

This point need not be labored. In cases involving merchandising difficult questions may arise as to when a particular form of activity falls within the domain of interstate and foreign commerce. In the business of transportation between a state and another state or territory or a foreign country, no such question can arise. For transportation is itself commerce.

In *Philadelphia and Southern Steamship Co. v. Pennsylvania,* 122 U. S. 326, 335, this court said:

> "The question which underlies the immediate question in the case is whether the imposition of the tax upon the Steamship Company's receipts amounted to a regulation of, or an interference with, interstate and foreign commerce, and was thus in conflict with the power granted by the Constitution to Congress? The tax was levied directly upon the receipts derived by the company from its fares and freights for the transportation of persons and goods between different States, and between the States and foreign countries, and from the charter of its vessels which was for the same purpose. This transportation was an act of interstate and foreign commerce. It was the carrying on of such commerce. It was that, and nothing else. In view of the decisions of this court, it

cannot be pretended that the State could constitutionally regulate or interfere with that commerce itself. But taxing is one of the forms of regulation. It is one of the principal forms. Taxing the transportation, either by its tonnage, or its distance, or by the number of trips performed, or in any other way, would certainly be a regulation of the commerce, a restriction upon it, a burden upon it. Clearly this could not be done by the State without interfering with the power of Congress. Foreign commerce has been fully regulated by Congress, and any regulations imposed by the States upon that branch of commerce would be a palpable interference. If Congress has not made any express regulations with regard to interstate commerce, its inaction, as we have often held, is equivalent to a declaration that it shall be free, in all cases where its power is exclusive; and its power is necessarily exclusive whenever the subject matter is national in its character and properly admits of only one uniform system. See the cases collected in *Robbins v. Shelby Taxing District,* 120 U. S. 489, 492, 493. Interstate commerce carried on by ships on the sea is surely of this character."

To the same effect is:

Gloucester Ferry Co. v. Pennsylvania, 114 U. S. 196.

It is Immaterial that the Taxpayer is Engaged in Intrastate as Well as Interstate Commerce, if in Fact Interstate Commerce is Burdened.

The State Supreme Court seems to have labored under the impression that interstate and foreign com-

merce can be taxed and burdened if the taxpayer, in addition to its interstate and foreign commerce, also engages in intrastate activities. This is not law. If in fact the burden operates upon interstate or foreign commerce, it is wholly immaterial that some intrastate business is also done.

Sprout v. South Bend, 277 U. S. 163;
New Jersey Bell Telephone Co. v. State Board of Taxes, 280 U. S. 338;
Cooney v. Mountain States Telephone & Telegraph Co., 294 U. S. 384.

In *Cooney v. Mountain States Telephone & Telegraph Co.,* 294 U. S. 384, 393, this court said:

> "* * * Where the tax is exacted from one doing both an interstate and intrastate business, it must appear that it is imposed solely on account of the latter; that the amount exacted is not increased because of the interstate business done; that one engaged exclusively in interstate commerce would not be subject to the tax; and that the one who is taxed could discontinue the intrastate business without also withdrawing from the interstate business."

The tax here involved fails to comply with at least three of the foregoing requirements. It is not imposed solely on account of intrastate business, because an additional tax is imposed, and was imposed in the present case, on account of interstate and foreign business. The amount of the tax is increased, and was increased in the present case, because of the interstate business done. Finally, a domestic corporation engaged exclusively in interstate commerce would be subject to

the tax, although the Supreme Court of the state held that a foreign corporation exclusively engaged in interstate commerce would not. The tax, therefore, fails to measure up to the requirements applicable where the taxpayer is engaged in both intrastate and interstate business.

The Objection that the State Tax Constitutes an Actual Burden Upon Interstate and Foreign Commerce Loses None of its Validity Because of the Fact that the Particular Taxpayer Happens to be a Domestic Corporation.

It is not permissible to impose a burden upon the interstate commerce carried on by any person or corporation whatever.

In *Philadelphia and Southern Steamship Co. v. Pennsylvania,* 122 U. S. 326, 344, this court held to be invalid a tax on the interstate commerce of a domestic corporation and said:

> "The decision in this case, and the reasoning on which it is founded, so far as they relate to the taxation of interstate commerce carried on by corporations, apply equally to domestic and foreign corporations."

Again, in *Galveston, Harrisburg & San Antonio Ry. v. Texas,* 210 U. S. 217, 228, the court said:

> "Of course, it does not matter that the plaintiffs in error are domestic corporations, or that the tax embraces indiscriminately gross receipts from commerce within as well as outside of the state."

To the same effect are:

Ozark Pipe Line Corporation v. Monier, 266 U. S. 555;

New Jersey Bell Telephone Co. v. State Board of Taxes, 280 U. S. 338;

H. K. Mulford Co. v. Curry, 163 Cal. 276, 286.

III. THE TAX IS NOT A MERE INCIDENTAL BURDEN ON INTERSTATE AND FOREIGN COMMERCE.

We anticipate an attempt to justify the present tax as involving "only the same kind of incidental and indirect effect as that which results from the payment of property taxes or any other and general contribution to the cost of government" (*American Manufacturing Co. v. St. Louis,* 250 U. S. 459, 464). No such justification can be sustained in the present case, however, because here the tax operates on "the act of engaging in interstate commerce" (*Pullman Co. v. Richardson,* 261 U. S. 330, 338) and the effect on interstate commerce is direct and immediate.

The Present Tax Is Not a Property Tax.

It is true that property taxes, so designated and calculated to reach specific assets within the taxing jurisdiction, are valid even though the property be used in interstate commerce; and in the case of such a tax the state may use any appropriate means of valuing the property, even by reference to a proportion of the gross receipts from such commerce, where the receipts would not themselves be directly taxable. *Pullman Co. v. Richardson,* 261 U. S. 330. In

the present case we have, of course, no tax on property. The tax here involved is not described as, or claimed to be, a levy on the assets of appellants; it is not imposed in lieu of the ordinary property taxes; its amount has no relation to the value of the property owned within the state; it is said to be a privilege, or excise, or franchise tax. Cases dealing with property taxes must therefore be disregarded.

Cases Involving Income Taxes do Not Apply.

The court below relied largely on cases involving state income taxes and particularly on *United States Glue Co. v. Oak Creek,* 247 U. S. 321. The essence of that decision lies in its treatment of an income tax as "but a method of distributing the cost of government, like a tax on property, or upon franchises treated as property". In the case of such a tax it was held that, in the circumstances appearing in the *United States Glue Co.* case, there was no direct burden on interstate commerce.

General property taxes and general income taxes may be levied by the states, and it is no objection that some of the property may have been used in commerce, or some of the income derived therefrom. In such cases the effect on commerce may be incidental and remote. On the other hand, even an income tax pure and simple may in its actual operation transcend the limits of permissible state action under the constitution, as in *Hans Rees' Sons v. North Carolina,* 283 U. S. 123.

But the reasoning of *United States Glue Co. v. Oak Creek,* supra, that the effect of a general income tax

on interstate commerce may be incidental, does not apply here, because the present tax is not an income tax. Any such claim was expressly denied in

Pacific Co., Ltd. v. Johnson, 285 U. S. 480.

See, also,

The Pacific Co., Ltd. v. Johnson, 212 Cal. 148.

We need not go beyond these decisions to show that no income tax is here involved. The state is not exerting its power to tax generally and directly all income of its residents and the purely local income of non-residents. It is, on the contrary, imposing an excise or privilege tax on the actual doing of business; it withholds the right to do business if the tax is not paid; it measures the amount of the tax, first, by the local or intrastate business of residents and non-residents alike, and then, in addition, by such part of the interstate and foreign income from residents and non-residents as arises from transactions within the borders of the state. It is as much an exaction on the doing of interstate and foreign commerce as if these appellants had been compelled to pay one dollar, or one hundred dollars, or one thousand dollars, on every passenger or pound of freight leaving the ports of the state for those of other states or foreign countries.

If the law were otherwise, the constitution could be nullified by a mere change in the manner of the measurement of the tax, although the burdening effect on commerce would be equally clear. The state, desiring to tax the actual transaction of interstate business, and knowing that a toll based on the total amount of operations, or on the number of instrumentalities em-

ployed, is forbidden, would only need to fix the toll as being a certain percentage of the interstate and foreign profits. The interstate operations would just as surely be burdened and controlled. To permit such evasion would, of course, destroy the constitutional limitation. And surely such a tax on the doing of business could not be justified because the state, if it refrained from taxing the business at all, and merely levied a general income tax on all net profits, would not exceed its powers merely because some of the income was originally derived from dealings in interstate commerce. The two situations are governed by wholly different considerations.

The error of the State Supreme Court lay in the assumption that because an income tax might be levied on all income of a resident, even though some of the income resulted from interstate transactions, therefore all restraints had been removed against a direct burden on interstate commerce, provided only that the exaction was measured by income. This assumption ignores the distinction between different kinds of taxes in respect to their actual operation and effect. Gross receipts from interstate commerce are not taxable directly, but may be validly used as a measure of a property tax. *Pullman Co. v. Richardson,* 261 U. S. 330. So of other subjects of taxation. The present tax burdens interstate commerce because it is avowedly directed against it, because it is aimed at a specific interstate activity, i. e., the transportation of passengers and freight from California, and because it taxes not property or income but the actual doing of business, including interstate and foreign business. Its

vice is inherent in its subject and object and exists wholly irrespective of the question whether its amount is gauged by the volume of transactions or by the net profit derived therefrom. In view of this subject and object, the doctrine that a general property or income tax may incidentally affect interstate commerce without impairment of its validity has no relevance to the present situation.

It is submitted, moreover, that the cases sustaining net income taxes go no further at their utmost than to furnish support for the proposition that possession of certain privileges may be taxed, for example the privilege of possessing the benefits of citizenship, or of owning property or carrying on business within the state; and that such a tax may, generally speaking, be measured by net income attributable to or connected with the possession of the privilege or group of privileges that are the subject of the tax, even though the same income is also attributable to or connected with property or activity not directly taxable. Thus in *Lawrence v. State Tax Commission,* 286 U. S. 276, in speaking of an income tax applicable to income from sources both within and without the taxing state, the court says that the power of the state is, with stated exceptions, unrestricted "so long as the tax imposed is upon property within the state or on privileges enjoyed there." The income tax cases certainly do not sustain any general proposition, to be mechanically applied, that a net income tax is not a burden on the income taxed. See *Alpha Portland Cement Co. v. Massachusetts,* 268 U. S. 203. Here, as in the *Anglo-Chilean* case, the tax is not a

tax on the possession of a privilege or group of privileges, but a tax directly upon the activity of engaging in foreign commerce.

Cases Providing for the Equitable Apportionment of the Value of a Unitary Business do Not Apply.

The court below relied also on

Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113, and

Bass, Ratcliff & Gretton v. State Tax Commission, 266 U. S. 271,

as sustaining the present tax.

Both of these cases involved corporations carrying on a unitary business, consisting partly of manufacturing and partly of selling. In the *Underwood* case the manufacturing activities were located in the taxing state, while in the *Bass, Ratcliff & Gretton* case only the selling activities were there carried on. The remaining activities of each corporation had their situs in other taxing jurisdictions. In the *Underwood* case Connecticut, and in the *Bass* case New York, undertook to impose a franchise tax. In each statute it was provided that where the business of a corporation was done partly within and partly without the state, the tax should be computed on that percentage of its total income which the property of the corporation within the state bore to the total value of its property. Obviously, the valuation of the local activities of unitary businesses, spread over many jurisdictions, was a difficult one. In many cases it would be difficult to determine mathematically what proportion of the

single, inter-related activity should be attributed to the manufacture of goods and what proportion to their sale. The allocation of total income in proportion to the value of the assets in the several states was held not to be unreasonable in the absence of a specific showing that interstate or extraterritorial values were being taxed, notwithstanding that some of the total income, which was used as one term of a complicated formula, had been derived from interstate or extraterritorial sources. The burden thus imposed was indirect and incidental to a reasonable method of ascertaining local values. Obviously no interstate or extraterritorial income as such was taxed.

The strict limitation of these cases is shown in *Hans Rees' Sons v. North Carolina,* 283 U. S. 123. That also was a case of a unitary corporate business, consisting both of manufacture and selling and spread over several jurisdictions. There also a state had imposed a tax upon that proportion of the total income which the local assets bore to the total assets; and the tax was levied, not on a franchise, but directly on the income itself. But proof was made of the exact proportion of profits which were attributable to the local manufacturing activities. It was held that since the formula approved in the *Underwood* case did in fact operate in such a way as to reach income which was not local, the tax was unconstitutional and void.

It follows that the mere use of total income as one element in a formula does not, in and of itself, show a tax upon interstate or extraterritorial values where the formula is not inherently unfair and shows no purpose to reach such constitutionally protected values,

and where there is no proof of its being applied to reach them. The result is otherwise where the facts show, as they did in the *Hans Rees* case, that notwithstanding the apparent fairness of the formula, the exempt object is really affected; and of course the result is otherwise where, as here, the state is consciously reaching out to add to the tax on local business, an additional tax "on the actual doing of business" levied with conscious and sole reference to those operations in interstate and foreign commerce which originate within its borders. To such a case the decisions on the fairness of the allocation of the value of a unitary business have no application.

Cases Dealing With Taxation of "Right to be" a Corporation have No Application.

The State Supreme Court cites *Schwab v. Richardson,* 263 U. S. 88. It and similar cases to the same effect have no relevance here, because they have to do with statutes which levy a tax on the "right to exist" of a domestic corporation. As pointed out above, this is not the character of the tax here involved. Neither by statutory description, nor by statutory operation, nor by judicial interpretation, can it possibly be so construed.

It is irrelevant that the state might have enacted a statute imposing a tax upon appellants' right to be a corporation, and might perhaps have measured that tax as this one is measured. The fact is that the state, for reasons sufficient to it, has not done so. As the court said in *Philadelphia and Southern Mail*

Steamship Company v. Pennsylvania, 122 U. S. 326: "Their business as carriers in foreign or interstate . . commerce cannot be taxed by the state under the plea that they are exercising a franchise."

See also *Anglo-Chilean Nitrate Sales Corporation v. Alabama,* 288 U. S. 218, in which case, as is apparent from the dissenting opinion, this point was in the court's mind, so that the decision necessarily stands for the proposition that in situations like the present one, the state's unexercised power to tax one subject will not sustain a tax on another subject.

IV. EVEN CONSTRUED AS THE STATE SAYS IT SHOULD BE, THIS TAX IS AN OCCUPATION TAX; AND BEING INCREASED BECAUSE OF INTERSTATE BUSINESS DONE, IS VOID.

The state's contention is that the tax here in question is a tax on the privilege of doing intrastate business. Our contention is that it is a tax directly upon the doing of business. In this part of our brief we shall assume with the respondent, that the tax is a tax on the privilege of doing intrastate business, making this assumption for the purpose of argument, in order to show that even if it were such a tax it would be void, at least as applied to income from interstate commerce.

As we have seen, payment of the present tax is a condition precedent to the continued transaction of intrastate business with respect to foreign corporations, and a condition precedent to the continued

transaction of any business with respect to domestic corporations. Thus, Section 32 of the Act provides in part:

> "Sec. 32. If a tax computed and levied hereunder is not paid before six o'clock p. m. on the last day of the twelfth month after the date of delinquency of the first installment thereof, the corporate powers, rights and privileges of the delinquent taxpayer, if it be a domestic corporation, shall be suspended, and if the delinquent taxpayer be a foreign corporation it shall thereupon forfeit its right to do intrastate business in this state."

Section 32 then goes on to say that after forfeiture of the right to go on with business because of nonpayment of the tax, continued activity shall be a misdemeanor, punishable by fine, or imprisonment, or both.

In the language of the Supreme Court of California, the present tax is "on foreign and domestic corporations * * * for the privilege of engaging in intrastate commerce." The state does not contend that this tax is a tax on the privilege of being a corporation.

It is, we submit, self evident that a tax on the privilege of carrying on an occupation, payment of which is a condition precedent to the continued carrying on of the occupation in question, is an occupation tax; a tax directly on the occupation. As the court said in *Leloup v. Port of Mobile,* 127 U. S. 640, concerning a tax described by the court as "a tax on

the privilege of doing the business" in which the taxpayer was engaged:

> "Of course, the exaction of a license tax as a condition of doing any particular business, is a tax on the occupation; and a tax on the occupation of doing a business is surely a tax on the business."

See also

Ozark Pipe Line Corp. v. Monier, 266 U. S. 555.

Now the whole of the present controversy arises out of the fact that the present tax, an occupation tax on corporations like appellants, that are engaged both in intrastate and interstate commerce, is greater because of the taxpayer's business in interstate commerce. The following statement from the opinion in *Sprout v. South Bend,* 277 U. S. 163, therefore applies:

> "A state may, by appropriate legislation, require payment of an occupation tax from one engaged in both intrastate and interstate commerce. * * * But in order that the fee or tax shall be valid, it must appear that it is imposed solely on account of the intrastate business; that the amount exacted is not increased because of the interstate business done; that one engaged exclusively in interstate commerce would not be subject to the imposition; and that the person taxed could discontinue the intrastate business without withdrawing also from the interstate business."

See

Cooney v. Mountain States Telephone and Telegraph Company, 294 U. S. 384, foot note 4.

An Occupation Tax That is Increased Because of the Taxpayer's Business in Interstate Commerce is Void, Whatever its Measure May be.

We have already shown that cases involving taxes imposed on the right to be a corporation are not in point. It may now be observed that *Sprout v. South Bend*, 277 U. S. 163, and the other cases cited above, establish the proposition that an occupation tax cannot be greater because the taxpayer is engaged in interstate commerce than it would be if he were not. It is clear, therefore, that a tax "for the privilege of engaging in intrastate commerce" cannot be validly "measured by" income from interstate commerce. The reasonableness of the rule so established is apparent. The levy of a tax for the privilege of engaging in intrastate commerce computed on the basis of income derived from interstate commerce cannot be defended as a *bona fide* attempt to reach the value to the taxpayer of the subject taxed.

V. THE STATE STATUTE AS INTERPRETED DENIES TO APPELLANTS THE EQUAL PROTECTION OF THE LAWS.

The tax under discussion is clearly one on the doing of business. If it is imposed on the doing of interstate and foreign business, it is void under principles already discussed. It can only be upheld as a tax on

the doing of intrastate or local business. This the lower court attempted to do. It said:

> "We are likewise of the opinion that the act clearly, without ambiguity, imposes on foreign and domestic corporations of the classes mentioned, when they are engaged in both intrastate and interstate commerce, for the privilege of engaging in intrastate commerce, a franchise tax measured by or according to their net income, and that the act provides in such cases that income from interstate or foreign commerce shall be included in measuring the tax to the extent limited in the act" (R. 66, 67).

It is not disputed that many corporations are subject to the act who do no interstate or foreign business at all, but whose business is confined to intrastate transactions. All such corporations pay four per cent of their income from such intrastate transactions and receive in return, according to the state Supreme Court, "the privilege of engaging in intrastate commerce". On the other hand, appellants and other corporations similarly situated, who do interstate as well as intrastate business, must pay, for the same privilege of engaging in intrastate commerce, not only four per cent of the income from their intrastate business, but also four per cent of such income from their interstate and foreign business as originates in California. The practical effect of the discrimination in the present case is that a corporation doing the same amount of intrastate business as appellants, but no interstate or foreign business, would pay for its so-called intrastate privilege only $12,845.30. If the tax stands, appellants must pay, for the same intrastate privilege,

not only this sum, but an additional $19,637.71, or something over 150% more than other corporations similarly situated with respect to intrastate business.

If the tax is levied on intrastate business, there is a clear case of unwarranted discrimination and a denial of the equal protection of the laws. There is no relation between the charge and the value of the privilege for which it is imposed.

Air-Way Electric Appliance Corporation v. Day, 266 U. S. 71.

The classification is not based on anything having relation to the purpose for which it is made, and the equal protection clause of the Fourteenth Amendment is therefore violated.

Southern Railway Co. v. Greene, 216 U. S. 400;
Royster Guano Co. v. Virginia, 253 U. S. 412.

In its opinion, the Supreme Court of California holds: (a) that the tax statute does not apply to foreign corporations which are doing business in this state, but which are engaged solely in interstate commerce; (b) that as to all corporations, foreign or domestic, doing some intrastate business, the statute does apply, and the tax is, as to them, computed on the entire net income derived from intrastate business, and on a portion of the net income derived from interstate business. These propositions are established by the following passages from the Supreme Court's opinion:

> "Thus the classification found in section 4 of the act here involved, as above quoted, necessarily excludes from the tax foreign corporations doing

business in this state but engaged solely in interstate commerce. . . .

"We are likewise of the opinion that the act clearly, without ambiguity, imposes on foreign and domestic corporations of the classes mentioned, when they are engaged in both intrastate and interstate commerce, for the privilege of engaging in intrastate commerce, a franchise tax measured by or according to their net income, and that the act provides in such cases that income from interstate or foreign commerce shall be included in measuring the tax to the extent limited in the act."

(R. 65, 66, 67.)

It appears unequivocally, therefore, that a foreign corporation doing business in California whose business consists exclusively of interstate commerce is not subject to any tax thereon or measured thereby, whereas another foreign corporation, doing precisely the same character and amount of interstate business, but which does some intrastate business also, is subject to a tax computed not only upon its total income from intrastate business, but in addition, upon part of its income from purely interstate business.

The resulting arbitrary discrimination renders the act void, we submit, both upon the grounds stated above and upon another ground, which is set forth in this court's opinion in *Royster Guano Co. v. Virginia,* 253 U. S. 412. In that case the court had to deal with a Virginia statute which taxed the entire net income of domestic corporations doing some business within the state and some without, but exempted

the income of domestic corporations "which do no part of their business within this State." The statute was held void as a denial of equal protection to corporations doing business both within and without the state.

The situation thus presented is identical with that in the case at bar. The tax in the *Royster* case was void because, as between two corporations similarly situated, it taxed the income of one of them derived from extrastate business but did not tax the income of the other, also derived from extrastate business. In the present case, as between two corporations similarly situated, part of the income of one of them derived from interstate commerce is taxed, but none of the income of the other derived from interstate commerce is taxed.

The provisions of the California statute (Sec. 4), so far as it imposes any tax, are simple, short and (we submit), inseparable:

> "Every financial, mercantile and manufacturing corporation doing business within the limits of this state . . . shall annually pay to the state for the privilege of exercising its corporate franchise within this state a tax according to or measured by its net income. . . ."

Likewise the provisions (Sec. 10), defining the business, to the doing of which the tax applies:

> ". . . if the entire business of such bank or corporation is not done within this state, the tax shall be according to or measured by that portion thereof which is derived from business done within this state."

Stated briefly, these provisions apply, under the decision of the court below, to (a) part of the income of domestic corporations derived from interstate and foreign commerce, and (b) part of the income of foreign corporations derived from interstate and foreign commerce where other and local business is done, but (c) none of the income of foreign corporations from interstate or foreign commerce where no local business is done. The application of the tax to either of the first two classes renders the tax void, not only as a burden on interstate commerce, but also under the equal protection clause.

VI. THE STATE STATUTE, AS INTERPRETED, DEPRIVES APPELLANTS OF THEIR PROPERTY, WITHOUT DUE PROCESS OF LAW.

Again we return to the proposition that the tax can be saved, if at all, only as a charge for the privilege of engaging in local or intrastate business. Appellants have paid, and the controversy does not involve, the statutory percentage of their income from all local or intrastate business (R. 61). They are now called upon to pay, in addition, the same percentage of a part of their income from interstate and foreign commerce—income which has no conceivable relation to the privilege for which the tax is imposed. This exaction is unreasonable, capricious and arbitrary and therefore deprives appellants of their property without due process of law.

Hans Rees' Sons, Inc. v. North Carolina, 283 U. S. 123

It is respectfully submitted that the judgment of the State Supreme Court should be reversed.

Dated, San Francisco, California,
December 23, 1935.

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(Appendix Follows.)